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(1)

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 933

THE WESTERN UNION TELEGRAPH COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 160-164) is not officially reported. The opinion of the Circuit Court of Appeals (R. 457-465) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 12, 1944 (R. 466). The petition for a writ of certiorari was filed April 26, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respective taxpayers executed long-term contracts leasing all of their properties to the petitioner in consideration of stipulated rentals to be paid by the lessee quarterly or semiannually directly to the lessors' stockholders of record as dividends upon their shares of stock. In addition to being lessee, petitioner was a majority or substantial stockholder of each of the lessors. The taxpayers have not paid the income taxes due in respect of their rental incomes and have no properties upon which levies may be made, the leased properties having been so intermingled with properties of petitioner that segregation is impossible. The question is whether petitioner is liable as transferee for the unpaid taxes under Section 311 (a) (1) of the Revenue Acts of 1928 and 1932 by reason of the rental dividends received by it as stockholder of the respective lessors.

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 311. TRANSFERRED ASSETS.

(a) *Method of collection.*—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the

provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) *Transferees*.—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.

* * * * *

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

* * * * *

(f) *Definition of "transferee."*—As used in this section, the term "transferee" includes heir, legatee, devisee, and distributee.

Section 311 of the Revenue Act of 1932, c. 209, 47 Stat. 169, is identical.

STATEMENT

The Commissioner of Internal Revenue determined that petitioner was liable as transferee under Section 311 of the Revenue Acts of 1928 and 1932 for unpaid income taxes due and owing for 1931, 1932, and 1933 from six corporations of which it was a stockholder. (R. 23-25, 180.)¹

¹ In the interest of brevity, record references are limited herein to the evidence and proceedings relating to the Gold

The taxes which the Commissioner has thus assessed against the petitioner are the following (R. 24-25, 161):

Taxpayer	1931	1932	1933
Gold & Stock Telegraph Co.....	\$36,000	\$41,250.00	\$41,250.00
Pacific & Atlantic Telegraph Co.....	9,600	11,000.00	11,000.00
New York Mutual Telegraph Co.....	18,000	20,625.00	20,625.00
Franklin Telegraph Co.....	2,640	3,437.50	3,437.50
Southern and Atlantic Telegraph Co.....		6,531.25	6,531.25
Empire and Bay States Telegraph Co. ¹	776	776.00	776.00

¹ The amount of the taxes of the Empire and Bay States Telegraph Company sought to be collected from petitioner has been limited to the dividends received for the respective years from this corporation, the taxpayer's liability for each year having exceeded petitioner's dividends on the shares of stock owned by it in the lessor company (R. 143-146, 424, 426). The amount of petitioner's annual dividends exceeded the liabilities of the respective tax payers in the companion cases.

The foregoing taxes were assessed and warrants of distraint issued against the respective lessor corporations but no part thereof was collected (R. 180). Thereupon the deficiencies listed above were asserted against petitioner as transferee (R. 180). The Commissioner's determination that petitioner was liable as transferee was based upon its receipt of dividends upon the stock which it owned in the taxpayer corporations (R. 173-174). It is conceded that the taxpayers primarily liable have no property or funds with which to satisfy their own obligations (R. 173-174).

The following schedule shows in the case of each taxpayer the amount of its outstanding and Stock Telegraph Company, unless differences or peculiarities make references to the companion proceedings desirable.

capital stock, the number of shares owned by petitioner and the annual dividends allocable to those shares (R. 172, 177, 263, 269, 300, 309, 346-347, 353, 380-381, 387, 418, 419, 424).

Taxpayer	Total shares of taxpayer outstanding		Shares owned by petitioner	Annual dividends allocable to petitioner's shares
	No.	Par value		
Gold & Stock Telegraph Co.....	50,000	\$5,000,000	29,476	¹ \$176,856.00
Pacific and Atlantic Telegraph Co.....	80,000	2,000,000	58,877	58,877.00
New York Mutual Telegraph Co.....	100,000	2,500,000	96,372	144,558.00
Franklin Telegraph Co.....	9,961	996,100	6,320	15,800.00
Southern and Atlantic Telegraph Co.....	37,962	949,050	15,639	19,548.75
Empire and Bay States Telegraph Co.....	3,000	300,000	194	776.00

¹ The amount of the annual dividends upon Western Union's stock in the Gold and Stock Telegraph Company amounted to \$153,336 for the year 1931 and to \$176,856 for 1932 and 1933 (R. 177).

The earliest lease involved was that of the Pacific and Atlantic Company, which was executed in 1873 for a period of 999 years (R. 282-286); and the latest lease was that of the Empire and Bay States Telegraph Company, executed in 1890 for a period of 99 years (R. 436-441). The other leases were for periods of either 99 years or 999 years (R. 189-196, 320-326, 364-367, 400-407). The respective instruments provided that in consideration of the lease of the properties, the lessee was to pay an amount equivalent to a specified percentage on the capital stock of the lessor corporations, and that these payments should be made directly to the stockholders of the lessors in proportion to their stock holdings as shown by the books at the time the payments were due (R. 191). In some instances the rental dividends

were payable quarterly (R. 191, 438), and in other instances semiannually (R. 283, 322, 365, 403). Since petitioner was both lessee and a stockholder of the lessors, the payment of the rentals and collection of its share of the dividends was handled in the following manner: the total rental was charged upon the books as an expense to a rental account (R. 177). The portion of the total payable to stockholders other than petitioner was deposited in a special account, upon which dividend checks were drawn payable directly to each of the stockholders (R. 177). The portion belonging to petitioner by reason of the shares of stock owned by it in each of the lessor corporations was credited to its dividend income account (R. 177).

The properties leased to petitioner have been so intermingled with its own properties that segregation is admittedly impossible (R. 173, 263-264, 301, 347, 382, 420). The payment of dividends upon the stock of the lessor companies was guaranteed by petitioner and this was evidenced in some instances by endorsements on each certificate (R. 173).

The United States Board of Tax Appeals stated that it felt constrained to follow certain decisions of the Second Circuit which it cited and held accordingly that petitioner was not liable as transferee, sustaining petitioner's contention here, indicating that its own opinion was otherwise (R. 161-164). The Second Circuit, overruling its own

earlier decisions followed by the Board, agreed with that tribunal and the Commissioner that petitioner was liable (R. 457-464). As to taxes owed by two of the lessor companies, however, the court affirmed the decision of the Board because of prior decisions of the court that petitioner was not liable for taxes owed by the same companies in earlier years, which rendered the issues as to liability for taxes upon the incomes of those companies *res judicata* (R. 464-465).

ARGUMENT

The taxpayer lessors leased all of their properties to petitioner for terms of 99 years or 999 years. Petitioner agreed to pay rent in the form of dividends directly to the lessors' stockholders of record as their interests should appear at the dates the rental dividends became payable. The properties leased have been so intermingled with the properties of petitioner that segregation is admittedly impossible and the taxpayers have no other assets upon which levies may be made to effect collection of the income taxes due from the taxpayers in respect of the rentals thus paid. That such rentals constituted income taxable to the lessors is settled (*United States v. Joliet & Chicago R. Co.*, 315 U. S. 44). Under these circumstances the Commissioner's determination to pursue the dividend distributions into the hands of petitioner, the majority stockholder of four of the taxpayers and a substantial stockholder of

the other two, was proper under the provisions of Section 311 of the Revenue Acts of 1928 and 1932 (*Phillips v. Commissioner*, 283 U. S. 589). The decision below holding petitioner liable as transferee is correct and there is no occasion for further review.

In effect the taxpayers declared dividends in the amount of their entire incomes and petitioner urges that by such action a corporation can create rights in its stockholders superior to the tax claims of the Government. This view has been correctly rejected by the court below, overruling its own earlier decisions to the contrary. It is strenuously urged, however, that the decision below construing and applying the federal revenue statute encroaches upon and is in conflict with the general rule that property rights must be determined under local law. (Pet. Br. 12-15.)

There is no conflict. The federal law grants to the Government certain rights in the case of transferred assets as an aid in tax collections, but this does not preclude the operation of state law in the event of any controversy concerning the property rights of the parties interested in the leases. We are not concerned here with any conflict of interest between the lessor and the lessee or the stockholders of the lessor, and we are not contending that the transfers by the lessors of their properties to the lessee were invalid. It is because the conveyances to the lessee were valid

that it is now necessary to collect the lessors' annual income taxes from the instant distributee, which, together with other stockholders, has been siphoning off the rental incomes of the lessors before they reached the tills of these companies. We think it clear that distributions of dividends by a corporation without any provision for the payment of annual income taxes make the recipients distributees within the meaning of Section 311 (f) of the federal statutes, and it matters not whether the distributions were authorized by the directors before or after they knew of the incidence of such taxes. However, if there were any inconsistency between the federal and local law, it is settled that federal revenue statutes are to be construed in the light of their general purpose to establish a nation-wide scheme of taxation uniform in their application, and not subject to state limitation unless the language of the statute, or its necessary implication, makes its application dependent on state law (*United States v. Pelzer*, 312 U. S. 399).

The fact that the Government may have an alternative remedy through applications for injunctions (*United States v. Morris & Essex R. Co.*, 135 F. 2d 711 (C. C. A. 2d), certiorari denied, 320 U. S. 754) does not indicate that the statutory remedy invoked here is improper.

We are here concerned only with the simple fact that annual transfers were made to the stock-

holders of the full amounts of the taxpayers' incomes without provision for the sovereign's taxes. This is the conventional situation in which a transferee liability arises.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1944.